COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

No. 50247-0-II

MICHAEL COHEN, et al.,

Appellants,

v.

WILLIAM NEWCOMER, et al.,

Respondents.

OPENING BRIEF OF APPELLANTS MICHAEL COHEN, JANE DOE COHEN, AND MC APEX, LLC

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I. INTRODUCTION

Appellants Michael Cohen, "Jane Doe" Cohen,[1] and MC Apex LLC request that this Court reverse a memorandum decision and order that would rescind and void potentially every single agreement entered into for a $26.5 million real estate development in Tacoma. The Superior Court's February 14, 2017 memorandum decision and February 24, 2017 order on Plaintiff Newcomer's Motion for Partial Summary Judgment and Defendant Apex's Cross Motion for Summary Judgment (the "Decision and Order") framed the single question that the Superior Court decided—and thus the subject of this appeal—as follows:

> The question of law before this Court on the current motion is narrow. At the January 9th, 2017, hearing the Court called for additional briefing to address the effect the jury's finding of misrepresentation in violation of the Washington State Securities Act (WSSA) by Defendant [Michael] Cohen in Pierce County Cause No. 14-2-05136 [the "*Newcomer I*" action] [had] on the instant litigation. Particularly, the issue of what effect the tendering back of Mr. Newcomer's interest in the Apex Apartments, LLC as required by RCW 21.20.430(1) has on subsequent, related transfers to the new entities must be determined. CP 2597.

In ruling that the post-trial judgment in the *Newcomer I* action had the effect of voiding not only the operating agreement for the original LLC formed to own the two-building real estate development, but also all of the

[1] "Jane Doe" Cohen refers to Julie McBride, who was named as a defendant in this action solely because of the marital community property she allegedly shared with Mr. Cohen during part of the time period relating to this lawsuit.

agreements and property transfers for the LLCs that were subsequently created for the multiple ownership restructurings, the Superior Court's Decision and Order committed a number of critical errors that all require reversal through this appeal.

First, the Decision and Order wrongfully rescinded and voided all of the project's LLC agreements based on a misunderstanding and misinterpretation of the judgment entered in the prior *Newcomer I* action. Specifically, the Superior Court believed that the LLC agreement for the original entity formed by Newcomer and other investors had been rescinded and "rendered void and unenforceable" by the *Newcomer I* judgment. CP 2598. This did not occur. Instead, the jury verdict and the judgment entered in *Newcomer I* awarded Newcomer damages, not the equitable remedy of rescission. The Washington State Securities Act ("WSSA") does not allow an aggrieved purchase to receive both remedies—rescission and damages—and Newcomer could not have received rescission in the *Newcomer I* litigation because he never submitted evidence to the court in that case that he had actually tendered his securities in the original LLC, which is a requirement for receiving rescission under RCW 21.20.430(1). (Damages are instead awarded under that statute if no such tender occurred.) Newcomer's lack of tender makes sense, as it is undisputed that he voluntarily withdrew as a member in the

original LLC and therefore ceased to own securities in it in 2008, six years before he filed the *Newcomer I* lawsuit. The Decision and Order's foundational assumptions—that the *Newcomer I* judgment awarded Newcomer rescission and that he had submitted evidence in that case that he had tendered the at-issue securities—are simply wrong. This unravels the entire basis for the Decision and Order.

Second, because RCW 21.20.430(1) only allows a purchaser to receive rescission **or** damages—and not both remedies—the Decision and Order effectively expanded the relief Newcomer had already received through the *Newcomer I* judgment to also award him rescission by voiding the operating agreement for the original LLC and every subsequent agreement and property transfer entered into in connection with the real estate development. This expansion of the relief already conferred in a prior judgment violates the rule of merger for judgments and is a separate basis for reversing the Decision and Order.

Third, the Decision and Order should not have granted Newcomer rescission because voiding the original LLC's operating agreement and all subsequent entities' agreements and transfers adversely impacts the interests of the other individuals and entities that invested in the development and that were not parties to the *Newcomer I* litigation. The judgment in *Newcomer I* applied only to Mr. Cohen and his marital

community, and Mr. Cohen is not the direct holder of any securities in the at-issue limited liability companies. (He holds his ownership interests through appellant MC Apex LLC, which is a separate legal entity that was not a party to the *Newcomer I* litigation and judgment.) The *Newcomer I* determination that Mr. Cohen violated WSSA simply does not apply to any of the third-party investors in this follow-on litigation. There is simply no basis to rescind and render void their investments in the development or the subsequent LLC agreements and property transfers into which they entered.

Fourth, the Superior Court should not have based its Decision and Order on RCW 21.20.430(5), which is an affirmative defense that bars a party that violated WSSA in connection with an agreement from enforcing that agreement. Newcomer did not plead this affirmative defense—or any other affirmative defense for that matter—prior to the Decision and Order, and thus could not have received a summary judgment ruling on the basis of that unasserted affirmative defense.

And **fifth**, looking beyond that procedural defect, the Superior Court misconstrued RCW 21.20.430(5), which applies only to an agreement that violates WSSA and the specific individuals who are found liable for such violation. Here, the Superior Court applied RCW 21.20.430(5) to agreements that were not at issue in the *Newcomer I*

judgment—the Newcomer Apex TIC LLC Agreement and the Apex Penthouse Condos LLC Agreement. Moreover, RCW 21.20.430(5) does not render the violative agreement "void"; instead, it only precludes an individual who violated WSSA from enforcing the violative agreement against the aggrieved party. The Decision and Order erred in this regard as well because the Superior Court used this narrow statutory provision to void the agreements for all of the LLCs formed in connection with the development and to bar the enforcement of their capital contribution requirements by innocent parties that were not subject to the *Newcomer I* judgment.

For all of these reasons, as more fully set forth herein, appellants Mr. Cohen, Ms. McBride, and MC Apex LLC request that the Court of Appeals reverse the February 14, 2017 memorandum decision and February 24, 2017 order. These appellants also join fully in the appellate brief filed by co-defendants Apex Apartments I TIC, LLC, Apex Penthouse Condos, LLC, and Newcomer Apex I TIC, LLC.

II. ASSIGNMENTS OF ERROR

1. The Superior Court erred by finding that the Apex Apartments LLC Agreement was "rendered void and unenforceable in the securities action [i.e., *Newcomer I*]," for each of the following reasons: (a) the judgment in the *Newcomer I* action awarded Newcomer only damages,

not rescission; (b) WSSA does not allow a person to receive both remedies (rescission and damages); (c) the Superior Court in this action is barred under the rule of merger from awarding Newcomer rescission for a WSSA violation because it expands the relief Newcomer already received for that WSSA violation in the *Newcomer I* judgment; and (d) rescission is an inappropriate remedy here in any event because it would adversely affect innocent third parties.

2. The Superior Court erred by expanding the scope of its Decision and Order to also void the Newcomer Apex TIC LLC Agreement and the Apex Penthouse Condos LLC Agreement, even though they represent separate agreements for separate entities that issued separate securities to investors, which securities were not the subject of Newcomer's WSSA claim in the *Newcomer I* lawsuit or the judgment entered on that claim.

3. The Superior Court erred by holding that the capital contribution obligations in the Apex Apartments I LLC Agreement, the Newcomer Apex TIC LLC Agreement, the Apex Apartments II LLC Agreement, and the Apex Penthouse Condos LLC Agreement are unenforceable under RCW 21.20.430 as to all defendants because (a) Newcomer failed to plead RCW 21.20.430 as an affirmative defense and yet was still granted relief based on it by the Superior Court at

summary judgment, (b) Newcomer submitted no evidence at summary judgment in this action that the Newcomer Apex TIC LLC Agreement and the Apex Penthouse Condos LLC Agreement violated WSSA, nor did the judgment in *Newcomer I* relate to these agreements and the distinct securities these LLCs issued to their members, and (c) the RCW 21.20.430 affirmative defense only renders unenforceable an agreement as to the particular party that violated WSSA in connection with that agreement; its bar to enforcement—based on its plain language—does not apply to any innocent parties seeking to enforce the agreement's provisions.

III. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

1. Whether the Superior Court erred by basing its decision to void the Apex Apartments LLC Agreement, the Newcomer Apex TIC LLC Agreement, the Apex Apartments II LLC Agreement, and the Apex Penthouse Condos LLC Agreement on its misunderstanding that the *Newcomer I* court had awarded rescission, when the judgment in *Newcomer I* had instead awarded only damages to Newcomer.

2. Whether the Superior Court erred by voiding under WSSA the Apex Apartments LLC Agreement because the *Newcomer I* judgment awarded Newcomer damages, not rescission, and WSSA does not allow a person to recover both types of remedies.

3. Whether the Superior Court erred by awarding Newcomer rescission because such a decision expanded the relief Newcomer had already received in *Newcomer I*, and such expansion of a judgment is not permitted under the rule of merger.

4. Whether the Superior Court erred by awarding Newcomer rescission because such relief is not appropriate where, as here, it would negatively impact innocent parties that are also members of the at-issue limited liability companies.

5. Whether the Superior Court erred by also voiding the Newcomer Apex TIC LLC Agreement, Apex Apartments II, LLC Agreement, and the Apex Penthouse Condos LLC Agreement because it found that the Apex Apartments LLC Agreement was void, where these other LLC agreements are independent from the Apex Apartments LLC Agreement and involve different securities.

6. Whether the Superior Court erred by finding that the Newcomer Apex TIC LLC Agreement, Apex Apartments II, LLC Agreement, and Apex Penthouse Condos LLC Agreement are unenforceable under RCW 21.20.430(5) where Newcomer failed to plead RCW 21.20.430(5) as an affirmative defense, thereby waiving it, yet the Superior Court nonetheless granted summary judgment to Newcomer on the basis of this unasserted affirmative defense.

7. Whether the Superior Court erred by deeming the capital-contribution obligations in the Newcomer Apex TIC LLC Agreement and the Apex Penthouse Condos LLC Agreement to be unenforceable by any party, even though (a) there are no allegations that these agreements violated WSSA, and (b) RCW 21.20.430(5) prevents only those people who have violated WSSA in connection with an agreement from enforcing that agreement.

IV. STATEMENT OF THE CASE

A. Newcomer Invests by Acquiring Securities in Apex Apartments, LLC

On February 16, 2005, Apex Apartments, LLC was formed to develop two luxury-apartment buildings near the Tacoma Mall. CP 104. These buildings are referred to herein as "Building A" and "Building B." At its inception, Apex Apartments, LLC had three primary members: William Newcomer, MC Apex, LLC,[2] and AMC Family LLC.[3] CP 132. The primary members each contributed $800,000 to acquire 30.33% of the Apex Apartments, LLC's membership units (i.e., its securities). *Id.* As part of their investment, each of the three primary members agreed to provide personal guarantees to the construction lender, Intervest Mortgage. *Id.* Apex Apartments, LLC also had three smaller investors,

[2] The manager of MC Apex, LLC is defendant Michael Cohen. CP 126.
[3] The manager of AMC Family LLC is Ken Thomsen. CP 127.

who each contributed $100,000 in exchange for 3% of that LLC's securities. *Id.* These three smaller members, who did not provide personal guarantees to the construction lender, are Eckstein Investments, LLC,[4] Entrust Northwest, LLC,[5] and RB&F Property Management LLC.[6] *Id.*

The Apex Apartments, LLC Agreement appointed a Manager—Michael Cohen—with authority to make capital-contribution requests and obligated each member to make additional capital contributions up to an amount equal to the value of the member's initial contribution to Apex Apartments, LLC. CP 109, 111, 115. Based on this agreement, Newcomer was obligated to contribute up to another $800,000 in capital contributions to Apex Apartments, LLC. CP 115, 132.

B. **The Development's Ownership Structure Is Changed in 2008, Resulting in the Formation of Distinct LLCs and the Issuance of New Securities.**

By March 1, 2008, Building A was complete and close to full occupancy. CP 993. At this point, the members of Apex Apartments, LLC unanimously decided to split the development into two distinct parts: "Phase I" and "Phase II." CP 157. Phase I related to ownership and operation of Building A. CP 76. Phase II focused on the ongoing

[4] The manager of Eckstein Investments, LLC is Todd Eckstein. CP 129.
[5] The authorized signatory for Entrust Northwest, LLC is William Donahoe. CP 130.
[6] The manager of RB&F Property Management, LLC is Roger Fierst. CP 131.

construction, ownership, and eventual operation of Building B. CP 632. To effectuate this split, the development's ownership structure was completely changed, with the result that new entities were formed to separately own each building, while the original entity, Apex Apartments, LLC, ceased to have an ownership interest in either building. CP 158.

With respect to the Phase I property, the ownership of Building A and the underlying real estate was split up and transferred by separate real estate deeds to two newly formed tenant-in-common entities (the "TIC Entities"): (1) a 30.33% interest in the Phase I property to Newcomer Apex I TIC LLC, which is wholly owned by Newcomer individually; and (2) a 69.67% interest in the Phase I property to Apex Apartments I TIC, LLC, which is owned by the other original members of Apex Apartments, LLC.[7] CP 221. Newcomer individually owned 100% of the membership units—i.e., the securities—in Newcomer Apex I TIC, LLC. CP 250. In connection with this transaction in 2008, Newcomer formally and voluntarily withdrew as a member of Apex Apartments, LLC, thereby ending his ownership interest in that entity as a matter of law. CP 158, CP 907.

[7] Since the development's inception, Newcomer had been pushing to convert his proportionate interest in Apex Apartments, LLC into a tenant-in-common interest to enable him to obtain IRC Section 1031 exchange deferred-tax treatment for any profits from a subsequent sale. CP 627–28. When the development was split in 2008, the new TIC ownership structure was implemented to accommodate Newcomer's request. CP 628.

The TIC Entities jointly operated Building A as a partnership or joint venture under a Tenant-in-Common Agreement, a Property Management Agreement, and the default rules of the Uniform General Partnership Act. CP 255, CP 259. Each TIC Entity also had its own LLC agreement. In the Newcomer Apex I TIC LLC Agreement, Newcomer agreed that his new initial capital contribution for the purpose of determining his future, additional capital-call obligations for Phase I would be equal to the value of 30.33% of the Phase I property, calculated as of March 20, 2008. CP 225, CP 236, CP 248, CP 253. The undisputed equity value of the Phase I property transferred to the TIC Entities on March 20, 2008, was at least $4,250,000. CP 1128, CP 2993.

With respect to the Phase II property, title to Building B and its underlying real estate was transferred by deed to another newly created entity, Apex Apartments II, LLC.[8] CP 159–90. Like the other newly formed entities, Apex Apartments II, LLC had its own LLC agreement, which Newcomer admitted controlled the terms of his investment in Apex Apartments II, LLC. CP 168, CP 1247–52. And, as with the other newly formed LLCs, the members of Apex Apartments II, LLC confirmed that they had separate capital-call obligations for that entity equal to the value

[8] Unlike the other LLC entities discussed in this Brief, Apex Apartments II, LLC is not a party to this case in any capacity and it is not represented by counsel in this litigation.

of the capital they each contributed to Apex Apartments II, LLC when it was formed. CP 170.

C. The Members of Apex Apartments II, LLC Add a New Equity Partner to Phase II and Further Divide the Underlying Property.

When the Great Recession hit, the Phase II development suffered and needed a cash infusion. On October 15, 2010, the members of Apex Apartments II, LLC entered into a Second Amended and Restated LLC Agreement of Apex Apartments II LLC to add a new equity partner to that LLC. CP 343. This new member contributed $4,300,000 in cash to Apex Apartments II, LLC. CP 343-403; CP 632–35. In conjunction with adding the new equity partner to Phase II, the original members of Apex Apartments II, LLC, including Newcomer individually, formed Apex Penthouse Condos, LLC ("Apex Condos") to hold the remaining for-sale-residential condominiums located on the top floor of Building B. CP 454. In the Apex Condos LLC Agreement, Newcomer, along with the other members of Apex Condos, agreed that each member's additional capital-call obligations would equal 100% of such member's initial capital contribution in that entity—i.e., the condos conveyed by deed to Apex Condos. CP 440, 444, 465. Similarly, in signing the Second Amended and Restated LLC Agreement of Apex Apartments II LLC, Newcomer agreed that he had separate capital-call obligations relating to Phase II that

were equal to 30.33% of $3,000,000 (Newcomer's relative share of the original members' $3,000,000). CP 383.

D. **Because of the Great Recession, Phase I and Phase II Needed to be Sold, and a Capital Call Was Necessary.**

By 2014, the Phase I and Phase II developments had still not fully recovered from the Great Recession. Both buildings still had critical cash-flow problems. Moreover, Apex Apartments II, LLC defaulted on its promissory note with Bank of America in the principal amount of $13,420,000, and Bank of America was threatening to foreclose and enforce the personal guarantees executed by Newcomer, Cohen, and Thomsen. CP 426.

Mr. Cohen and his management team avoided this disaster by finding a purchaser for the Phase I and Phase II properties (excluding the condominiums owned by Apex Condos) for $26,500,000. CP 559. The sale of Phase I and Phase II was the best remedy to stave off foreclosure and a deficiency action against the guarantors, including Newcomer. Unfortunately, when the sale proceeds were allocated between the two buildings in proportion to the number of apartments in each, Building A needed an additional $1,653,679.23 to close the deal. CP 605–06. Mr. Cohen approached Newcomer and his Newcomer Apex I TIC LLC to contribute at least a portion of the shortfall to avert catastrophe, but

Newcomer refused to help. CP 2713 at ¶¶ 4–8, CP 556–57, CP 565–67. As a result, Mr. Cohen and Mr. Thomsen were each forced to loan $824,000 to the Phase I partnership, thereby bestowing a benefit on Newcomer (a release from his personal guaranty to Bank of America) at the unfair expense of Mr. Cohen and Mr. Thomsen. CP 2713–14 ¶¶ 4–8, CP 573–80, CP 600–04.

On April 30, 2014, the sale closed for the properties owned by the TIC Entities and Apex Apartments II, LLC. CP 605–07. After paying off secured creditors and other liabilities, the TIC Entities and Apex Penthouse Condos, LLC together owed Messrs. Cohen, Newcomer, and Thomsen (or their respective entities) more than $6.1 million for amounts they had loaned over time to prop up the Phase I and Phase II developments. CP 605–07. On March 9, 2015, Mr. Cohen, as Manager of the TIC Entities and the Apex Condos, sent a letter to Newcomer and the entities' other members to convey that a capital call was necessary to pay the entities' debts. CP 660–61. The letter also noted that the members' capital obligations likely exceeded the debts owed to the members who had loaned additional money to the project (i.e., Messrs. Cohen, Newcomer, and Thomsen). CP 660–61. Therefore, Mr. Cohen, in his role as Manager, proposed that the members that were owed money should agree to offset those amounts by their corresponding capital contribution

liabilities under the various LLC agreements, thereby netting-out the obligations. CP 660–61.

Newcomer did not respond to Mr. Cohen's letter. Nor did he pay his outstanding capital call obligations. Thus, on March 18, 2016, Mr. Cohen, again in his role as Manager for the various entities, sent a second letter to Newcomer. This letter notified Newcomer that the all of the debts owed to him had been offset by his capital-call obligations. CP 999–1000, CP 2716–17 ¶¶ 15–16.

E. **Newcomer Files the *Newcomer I* Lawsuit Against Cohen, Claiming a Securities Violation in Connection With the Apex Apartments LLC Agreement.**

On January 13, 2014, Newcomer sued Mr. Cohen and his former wife, Julie McBride,[9] alleging a WSSA violation in connection with the securities Newcomer formerly owned in Apex Apartments LLC—securities which Newcomer disposed of when he withdrew as a member of that entity. CP 2298–99. A jury trial was held on Newcomer's WSSA claim, after which the jury entered a verdict in favor of Newcomer. CP 1098–99.

The *Newcomer I* jury found Mr. Cohen and his marital community liable under WSSA in connection with the sale of securities to Newcomer,

[9] As in the present lawsuit, Ms. McBride was named as a defendant in *Newcomer I* solely in her capacity as owner of the marital community that she formerly shared with Mr. Cohen during part of the relevant time period.

and awarded him $2,309,552 in damages. CP 1098, 1111. The jury verdict—which was based on the verdict form Newcomer proposed—did not award Newcomer the remedy of rescission because he did not request that form of equitable relief.[10] CP 1098. Nor did the verdict purport to void the Apex Apartments LLC Agreement or any of the other LLC agreements that were subsequently entered into in connection with the restructuring of the Phase I and Phase II developments. *Id.*

The *Newcomer I* trial court subsequently entered judgment on the verdict against Mr. Cohen and his marital community. CP 1111. That judgment awards Newcomer damages, consistent with the jury's verdict. *Id.* The final judgment did not award Newcomer rescission or otherwise void any agreements. *Id.* The judgment did not state that Newcomer had tendered to defendants any of the securities at issue in that litigation because Newcomer never introduced into evidence any indication that he had done so. *Id.* This is not surprising because Newcomer had withdrawn long ago as a member of Apex Apartments LLC in 2008 and did not personally hold any securities in any of the various LLCs at the time he filed the *Newcomer I* suit. CP 158, CP 1313–14.

[10] Under RCW 21.20.430(1), a purchaser is entitled to only rescission if it still owns the security; a purchaser is entitled to only damages if it does not still own the security.

F. **Newcomer Files the Instant Lawsuit Seeking to Collect on a Promissory Note That Was Satisfied in Connection With the Capital Contribution Demand.**

On January 21, 2016, Newcomer filed this action to recover on a promissory note (the "Note") against Apex Penthouse Condos, LLC, Apex Apartments I TIC, LLC, and Mr. Cohen.[11] CP1–5. In response, Mr. Cohen filed a cross-claim for indemnification against Apex Apartments I, LLC, Apex Apartments I TIC, LLC, and Apex Penthouse Condos, LLC, and a third-party claim against BR Newcomer, LLC for failing to honor its payment obligations under the promissory note Newcomer was trying to enforce against Mr. Cohen. CP 2666–2676. Apex Penthouse Condos, LLC and Apex Apartments I TIC, LLC filed their own counterclaims, cross-claims, and third-party claims against their respective members to (1) seek the judicial dissolution of the Phase I partnership formed by the TIC Entities; and (2) resolve and marshal partnership assets and debt priority. CP 49–67. Newcomer's operative Answer to the counterclaims does not contain any affirmative defenses. CP 1026–30.

On December 23, 2016, January 6, 2017, and January 9, 2017, the Superior Court held hearings on various summary judgment motions filed by the parties. The issues included whether Newcomer and the third-party defendant members are obligated by the limited-liability-company

[11] Ms. McBride was again named as a defendant solely for purposes of the marital community she previously shared with Mr. Cohen.

agreements to comply with the capital-contribution demands made in 2015 and 2016, and whether these members have any non-frivolous defenses to their capital-call liability.

At the December 23, 2016 hearing, the Superior Court denied Newcomer's Motion for Summary Judgment, which sought to establish liability under the Promissory Note. CP 2098–2100. Newcomer sought reconsideration of that order on January 3, 2017. CP 2258. In that motion, Newcomer argued that Mr. Cohen could not enforce any of the LLC agreements against him because of the prior *Newcomer I* judgment, that those agreements were voidable because they were entered into based on a misrepresentation or omission, and that Newcomer had allegedly voided all of the agreements by tendering any securities he owned back to Mr. Cohen. CP 2259. As with his operative Answer, Newcomer's reconsideration motion did not raise the statutory affirmative defense under RCW 21.20.430(5).

On January 9, 2017, the Superior Court denied the Cross-Motion for Partial Summary Judgment filed by defendants Apex Penthouse Condos, LLC and Apex Apartments I TIC, LLC, which had been heard on December 23, 2016 (CP 2266–68), but granted in part those same defendants' Motion for Partial Summary Judgment on Various Issues. CP 2270–74. During the January 9, 2017 hearing, though, the Superior Court

requested additional briefing from the parties regarding what effect the *Newcomer I* judgment had on the instant litigation, including the LLC entities that were subsequently formed and the transfers of real property that they received. CP 2597.

After the parties submitted the requested supplemental briefing—briefing in which Newcomer raised for the first time his unasserted affirmative defense under RCW 21.20.430(5)—the Court issued its memorandum decision on February 14, 2017, and its order on February 24, 2017. CP 2595, 2600. The Decision and Order (a) granted upon reconsideration Newcomer's motion for summary judgment, (b) denied the Cross-Motion for Summary Judgment filed on November 23, 2016 by defendants Apex Penthouse Condos LLC and Apex Apartments I TIC, LLC, and (c) voided the Apex Apartments LLC Agreement as well as the agreements for Apex Apartments II, LLC, Newcomer Apex I TIC LLC, and Apex Penthouse Condos, LLC. *Id.* The Superior Court assumed as part of its ruling that (a) Newcomer had tendered any securities he had during the *Newcomer I* litigation and (b) that the judgment in that action had awarded him rescission. In doing so, the Superior Court in essence called into question the entirety of the Phase I and Phase II developments by determining that "all transfers subsequent to the origination of Apex Apartments, LLC are void as a consequence of the securities action

findings[.]" CP 2598. While Mr. Cohen and the other appellants absolutely disagree that this extremely broad statement could be correct under any view of the law, taken literally, this means that even subsequent transfers such as the ultimate sale of the Phase I and Phase II properties to the non-party purchaser could fall within this broad statement by the Superior Court.

V. ARGUMENT[12]

The Superior Court's Decision and Order is plagued by a host of deficiencies that require reversal. The *Newcomer I* judgment did not void the Apex Apartments LLC agreement. It awarded Newcomer damages, not rescission. And having received damages, both WSSA and the rule of merger for judgments bar Newcomer from now receiving in this litigation the additional remedy of rescission. Nor does RCW 21.20.430(5) allow Newcomer to avoid his capital call obligations in the Newcomer Apex TIC LLC and the Apex Penthouse Condos LLC agreements. RCW 21.20.430(5) merely prevents a person who has committed a WSSA violation from suing on the contract. RCW 21.20.430(5) does not prevent suits on any other contracts and does not prevent innocent third parties from enforcing any contractual obligations.

[12] Because this is an appeal from a summary judgment decision and order, the standard governing this appeal is *de novo* review. *Ranger Ins. Co. v. Pierce County*, 164 Wn.2d 545, 552, 192 P.3d 886 (2008).

The Superior Court's decision to void the Newcomer Apex TIC LLC and the Apex Penthouse Condos LLC agreements, allowing Newcomer to escape his capital-call obligation, is not supported by the law, is overbroad, and unduly prejudices the innocent parties to whom Newcomer owed the capital-call obligation. That decision, and its accompanying order, must be reversed.

A. The Superior Court Erred by Granting Rescission to Newcomer and Voiding All of the Agreements and Underlying Property Transfers Relating to the Development.

1. Newcomer Was Awarded Damages, Not Rescission in the *Newcomer I* Litigation.

The *Newcomer I* judgment did not void the Apex Apartments LLC agreement, contrary to what the Superior Court stated in its Decision at CP 2598 ("The contract relative to the Apex Apartments LLC was rendered void and unenforceable in the securities action."). Instead, the *Newcomer I* judgment awarded Newcomer damages to compensate for the supposed misrepresentations he alleged at trial. This can be seen from the jury's verdict and the resulting judgment that was entered, both of which make it clear that Newcomer was awarded damages, and not the equitable remedy of rescission. *See* CP 1098, 1111. Neither the jury verdict nor the final judgment purported to void the Apex Apartments LLC agreement, let alone the agreements for any of the subsequent LLCs that were formed or the multiple property transfers that divided up and reorganized—multiple

times—the ownership structure for the development's various components.

WSSA permits an aggrieved buyer to seek rescission only if it still owns the security and tenders it before judgment is entered. *See* RCW 21.20.430(1). If a buyer cannot tender the security, the buyer is limited to seeking damages under RCW 21.20.430(1)'s plain language. *Id.* Rescission voids the contract and returns the consideration paid for the security, plus interest, to the aggrieved buyer, less any income received from the security. *Id.*; *see also Burgess v. Premier Corp.*, 727 F.2d 826, 837 (9th Cir. 1984) ("Rescission voids the transaction and returns to both parties the consideration they paid.").[13] When a buyer cannot tender the security and instead receives damages, the contract is not automatically void. *See, e.g., In re Washington Public Power Supply System Sec. Litig.*, 650 F. Supp. 1346, 1355 (W.D. Wash. 1986) (awarding damages, instead of rescission, where it would be inappropriate to void the contract).

In the *Newcomer I* litigation, Newcomer sought only damages. Newcomer did not ask the *Newcomer I* court for rescission or to otherwise void the Apex Apartments LLC agreement (or any other agreement). Nor could he have done so because at the time Newcomer filed that lawsuit, he

[13] *See Somerset Comm's Group, LLC v. Wall to Wall Advertising*, No. C13-2084 JCC, 2016 WL 4063938, at *1 n. 1 (W.D. Wash. Jan. 28, 2016) ("The Washington State Securities Act has similar requirements and is construed in conformity with federal law.").

no longer held the underlying securities at issue in that suit and thus could not tender them. *See Windswept Corp. v. Fisher*, 683 F. Supp. 233, 239 (W.D. Wash. 1988) (tendering securities back to seller is necessary for rescission under WSSA).

Having transferred the securities that formed the basis for his WSSA claim, Newcomer could seek damages but not rescission because he could not tender the original securities on which he based his claim. (Nor did Newcomer submit any evidence of tender during the *Newcomer I* trial or at any point prior to entry of judgment (CP 1786).) Damages is therefore the relief that was awarded to Newcomer in *Newcomer I*, contrary to what the Superior Court incorrectly assumed in its Decision and Order.

2. **Because Newcomer Received Damages, Both WSSA and the Rule of Merger Bar Him From Also Receiving Rescission.**

Having received damages in the *Newcomer I* litigation, Newcomer cannot now receive the additional remedy of rescission in this litigation for the same alleged securities violations. WSSA is explicit that an aggrieved buyer can receive rescission **or** damages, but not both. *See* RCW 21.20.430(1) (the aggrieved buyer "may sue either at law or in equity to recover the consideration paid for the security, together with interest at eight percent per annum from the date of payment, costs, and

reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security, ***or for damages if he or she no longer owns the security***.") (emphasis added); *see also Helenius v. Chelius*, 131 Wn. App. 421, 432–433, 120 P.3d 954 (2005) (RCW 21.20.430 "does not provide for an election of remedies," it provides for damages "if the security cannot be recovered; in all other cases, rescission is the applicable remedy"). Accordingly, with Newcomer having received damages in *Newcomer I*, the Superior Court contravened RCW 21.20.430(1)'s plain language by awarding Newcomer rescission. Its Decision and Order must be reversed.

The Superior Court's decision to expand the relief Newcomer received in connection with the WSSA violation he asserted in *Newcomer I* also violates the rule of merger that applies to judgments. After a final judgment is entered, the rule of merger precludes a plaintiff from obtaining additional relief in a subsequent action based on the claims covered by the prior action's final judgment. *See* Restatement (Second) of Judgments §18 Judgment for Plaintiff—The General Rule of Merger (1982); *Caine & Weiner v. Barker*, 42 Wn. App. 835, 837, 713 P.2d 1133 (1986) (adopting the Restatement (Second) of Judgments §18; "The merger rule is based in part upon the need to prevent vexatious relitigation of matters that have already passed into judgment as between the parties to

the litigation and their successors."). Under this rule, a person cannot obtain a money judgment in one action and then later seek to expand the relief granted by the judgment to include equitable relief in a subsequent proceeding. One of the Restatement's examples makes this clear:

> A and B enter into a contract for the sale of land located in State X. B refuses to convey the land. A brings an action for specific performance in State X, and a judgment is entered in his favor ordering B to convey the land. A is precluded by the judgment from maintaining a second action in State X to secure money damages in lieu of specific performance, or to obtain damages for delay in conveying the land in addition to the specific performance already adjudged.

Restatement (Second) of Judgments §18, cmt. b, illustration 3. The Restatement also explains that the rule of merger applies to counterclaims, thereby blocking a party that obtained relief in one lawsuit from seeking to expand that relief in a later lawsuit regardless of who brings that lawsuit. *Id*. at cmt. i. Appellants raised this argument below with the Superior Court. *E.g.*, CP 2408, 2759. The Superior Court did not address it in its Decision or Order, and both must be reversed on this basis as well.

3. **The Court Should Not Have Awarded Rescission Because Doing So Adversely Affects Innocent Parties.**

Even when a court is able to award rescission, unlike the Superior Court here, it must decline to do so if rescission will adversely affect innocent third parties. *See Yount v. Indianola Beach Estates, Inc.*, 63 Wn.2d 519, 524, 387 P.2d 975, 978 (1964) (holding court did not abuse its

discretion by awarding damages instead of rescission because rescission would have adversely affected an innocent third party); *Bernard v. Benson*, 58 Wash. 191, 198, 108 P. 439, 442 (1910) ("We think the true rule, and the one which best harmonizes with the broad principles of equity, is that specific performance will be denied when rights of innocent third parties have intervened so that the enforcement of the contract would be harsh, oppressive, or unjust to them."); *In re Spence*, No. 97-19586-SSM, 1999 WL 35108963, at *6 (Bankr. E.D. Va. May 24, 1999) ("A contract procured by fraud is not void, but voidable only, at the option of the party defrauded. It is binding upon him until rescinded, and if, before he exercises the option to rescind, innocent third parties have, in reliance on the fraudulent contract, acquired rights which would be prejudiced by its rescission, they may generally have it enforced for their benefit, although the party by whose fraud it was procured could not do so."); *Butera v. Countrywide Home Loans, Inc*., No. CV F 09-1677 LJO SMS, 2009 WL 3489873, at *5 (E.D. Cal. Oct. 26, 2009) (holding rescission is not available if awarding rescission would affect the interests of innocent non-parties); *Stephens v. Am. Home Assur. Co*., 811 F. Supp. 937, 948 (S.D.N.Y. 1993), *vacated on other grounds and remanded sub nom. Stephens v. Nat'l Distillers & Chem. Corp*., 70 F.3d 10 (2d Cir. 1995) ("Out-of-state cases cited by the Liquidator stand for the proposition that

the remedy of rescission may not be equitable in a given case where the rights of innocent third parties may be affected.").

The Superior Court's decision to void the Apex Apartments, LLC Agreement, the Newcomer Apex TIC LLC Agreement, the Apex Apartments II LLC Agreement, and the Apex Penthouse Condos LLC Agreement adversely affects the interests of innocent parties, none of which were subject to the judgment entered in the *Newcomer I* litigation. For example, by voiding all of the LLC agreements, the Superior Court is allowing Newcomer to escape the capital contribution obligations he owes to the other investors in those LLCs. Newcomer committed to other investors to contribute additional capital if required when he executed the LLC Agreement for Newcomer Apex I TIC, LLC. And Newcomer had committed to the other investors to contribute additional capital if required when he executed the LLC Agreement forming Apex Penthouse Condos, LLC. Yet, when he received the capital call demands for these entities, he refused to contribute and he ignored the Manager's offer to offset Newcomer's capital call obligations against the amounts owed to him for the various amounts he had previously loaned to those LLCs.

The result of Newcomer's failure to make the capital contributions he had agreed to make is that the other investors are now left to cover Newcomer's portion of the amount owed. These other investors are the

members of Apex Apartments I TIC LLC and Apex Penthouse Condos LLC, including AMC Family LLC, Eckstein Investments, LLC, Entrust Northwest, LLC, and RB&F Property Management, LLC. None of these investors were found to have committed any securities violations. Newcomer never even accused these investors of committing securities violations. These investors are truly innocent and should not have been forced to cover Newcomer's capital obligations.

The Superior Court provided no justification for allowing Newcomer to shirk his capital obligations with respect to these innocent investors. It was wholly inequitable for the Superior Court to void the Newcomer Apex TIC LLC Agreement, the Apex Penthouse Condos LLC Agreement, or any of the other LLC agreements and related property transfers given the adverse impact on the innocent investors' interests.

B. **RCW 21.20.430 Does Not Allow Newcomer to Avoid His Capital-Call Obligations.**

The *Newcomer I* judgment awards Newcomer damages but does not void the Apex Apartments LLC Agreement. To the extent that the Superior Court below believed voiding the Apex Apartments LLC Agreement was a necessary consequence of the *Newcomer I* judgment, the Superior Court erred. The Superior Court further erred by finding that the Newcomer Apex TIC LLC Agreement and the Apex Penthouse Condos

LLC Agreement were "necessarily void" under the affirmative defense set forth in RCW 21.20.430(5), because they involved subsequent transfers of the Apex Apartments, LLC property.

RCW 21.20.430(5) prohibits a person who has violated WSSA from suing "on the contract," but does not void the contract. RCW 21.20.430(5) does not bar innocent parties from suing on the contract, nor does it prevent anyone from enforcing contracts that do not violate WSSA. At most, the Superior Court could have prevented only Mr. Cohen from enforcing the Apex Apartments LLC Agreement in his personal capacity. Instead, the Superior Court ruled that RCW 21.20.430(5) prevented ***all*** of the defendants from enforcing the capital-call obligations in the Newcomer Apex TIC LLC Agreement and the Apex Penthouse Condos LLC Agreement. This ruling is not supported by RCW 21.20.430(5) or relevant case law, and it prejudices innocent parties. It must be reversed.

1. **Newcomer Did Not Plead RCW 21.20.430 as an Affirmative Defense and Should Not Have Been Awarded Relief Based on This Unasserted Defense.**

As an initial matter, the Superior Court erred when it ruled on summary judgment that RCW 21.20.430(5) applied to the Apex Apartments LLC Agreement, the Apex Apartments II, LLC Agreement, the Newcomer Apex TIC LLC Agreement, and the Apex Penthouse Condos LLC Agreement because RCW 21.20.430(5) is an affirmative

defense that Newcomer did not plead in his operative answer. CP 1026. (Indeed, Newcomer did not plead any affirmative defenses in his answer.) RCW 21.20.430(5) is an affirmative defense based on illegality, and must be alleged in a responsive pleading. *See* CR 8(c) (requiring parties to affirmatively plead certain defenses, including fraud, illegality, and "any other matter constituting avoidance or affirmative defense"); CP 2529 (Official Comment 15 on the Uniform Securities Act—upon which WSSA is based—stating that the non-enforcement provision "is intended to apply only to actions to enforce illegal contracts"). By failing to plead RCW 21.20.430(5) in his answer to the defendants' counterclaims, Newcomer waived this affirmative defense and it should not have been considered by the Superior Court in connection with its summary judgment decision. *See, e.g., Harting v. Barton*, 101 Wn. App. 954, 962, 6 P.3d 91 (2000) (affirmative defenses are waived unless affirmatively pleaded, asserted in a 12(b) motion, or tried by the express or implied consent of the parties). The purpose of this rule is to avoid surprise. *See Hogan v. Sacred Heart Medical Center*, 101 Wn. App. 43, 54–55, 2 P.3d 968 (2000). The requirement to plead affirmative defenses is only excused when the failure to plead the affirmative defense does not cause surprise or otherwise affect the substantial rights of the other party. *Id.*

Here, Newcomer not only failed to plead RCW 21.20.430(5) as an affirmative defense, he did not even raise this statute as a defense in any way, shape, or form until ***after*** three rounds of oral argument on summary judgment motions, when the Superior Court asked for supplemental briefing on the effect of the *Newcomer I* judgment. CP 2341. Not only did Newcomer's last-minute invocation of this defense catch defendants by surprise, it deprived them of the opportunity to conduct discovery on the defense and to more thoroughly address this affirmative defense in the summary judgment briefing and at oral argument. This is exactly the situation CR 8(c) was designed to prevent.

Newcomer first raised RCW 21.20.430(5) as a statutory defense to his capital-call obligations in his January 19, 2017 brief that was supposed to be limited to the question of whether the *Newcomer I* judgment granted "rescission" of his interest in any of the LLCs that were formed after Apex Apartments, LLC. CP 2341. This left the defendants three business days and only five pages to respond to a defense that Newcomer never raised previously in: (1) any prior pleading; (2) in any discovery response; (3) in his motion for partial summary judgment; (4) in his reply to motion for partial summary judgment; (5) at any of the three summary judgment hearings; or in (6) his January 3, 2017 Motion for Reconsideration. The Superior Court erred by allowing Newcomer to raise this unpleaded

affirmative defense so late in the summary judgment process and by basing the Decision and Order on it.

2. **The Agreements Are Not Void Under RCW 21.20.430(5).**

RCW 21.20.430(5) does not make the Apex Apartments LLC agreement void, even though the *Newcomer I* jury verdict and judgment determined that Mr. Cohen had made a material misrepresentation in connection with that agreement. In finding that the agreement was void, the Superior Court misinterpreted RCW 21.20.430(5), which merely prevents a person who has violated WSSA from basing a lawsuit on the infringing contract. *See* RCW 21.20.430(5) ("No person who has made or engaged in the performance of any contract in violation of any provision of this chapter or any rule or order hereunder, or who has acquired any purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation, may base any suit on the contract."). Nowhere does RCW 21.20.430(5) state that it voids the at-issue contract.

Although no Washington case expressly discusses this issue, case law addressing the parallel federal securities statute, 15 U.S.C. §78cc(b), makes clear that contracts that violate securities laws are not automatically void. In *Mills v. Electric Auto-Lite Co*., 396 U.S. 375, 387–88 (1970), the U.S. Supreme Court held that even though a merger was found to have

been obtained "by means of a materially misleading solicitation" in violation of the federal securities laws, the merger contract was not automatically rendered "void" or a "nullity" under §78cc(b). Although §78cc(b) prevents a "guilty party" from enforcing rights against an "innocent party" when the circumstances require it under equitable principles, the U.S. Supreme Court held that this "does not compel the conclusion that the contract is a nullity, creating no enforceable rights even in a party innocent of the violation." *Id.*

By the clear terms of RCW 21.20.430(5), this statute prohibits only persons who have violated WSSA from asserting claims on the infringing contract. This statute does not prohibit any claims that are not "on the contract"—including claims seeking to enforce ***other*** contracts, such as the Newcomer Apex TIC LLC Agreement and the Apex Penthouse Condos LLC Agreement. Nor does RCW 21.20.430(5) prohibit persons who have not violated WSSA from asserting any claims based on the at-issue contract.

a. **There Has Been No Judgment or Determination That the Newcomer Apex TIC LLC Agreement and the Apex Penthouse Condos LLC Agreement Violated WSSA, and Thus RCW 21.20.430(5) Cannot Apply to Those Agreements.**

The capital-call contributions that the defendants in this litigation seek to enforce against Newcomer arise from the Newcomer Apex TIC

LLC Agreement and the Apex Penthouse Condos LLC Agreement. In *Newcomer I*, Newcomer never argued or otherwise asserted claims alleging that the Newcomer Apex TIC LLC Agreement or the Apex Penthouse Condos LLC Agreement violated WSSA in any way. Thus, there is no reason for the Superior Court in the present litigation to rule that the Newcomer Apex TIC LLC Agreement and the Apex Penthouse Condos LLC Agreement, including their capital-call obligations, are void or otherwise unenforceable under RCW 21.20.430(5).

Despite the fact that there was no argument, ruling, verdict, or judgment in *Newcomer I* that the Newcomer Apex TIC LLC Agreement and the Apex Penthouse Condos LLC Agreement violated WSSA, the Superior Court held that these agreements were "necessarily void as well" under RCW 21.20.430(5) because they involved "subsequent transfers involving the Apex Apartments, LLC property." CP 2598. The plain language of RCW 21.20.430(5) does not support the Superior Court's conclusion.

The Superior Court's decision to extend RCW 21.20.430(5) to contracts that themselves do not violate WSSA rests on a misinterpretation of *Goldberg v. Sanglier*, 92 Wn.2d 874, 639 P.2d 1347 (1982). That case states, in pertinent part:

> If a contract is illegal, our courts will leave the parties to that contract where it finds them.… The same rule applies if the contract grows immediately out of and is connected with an illegal act.

Id. at 879 (citations omitted). But there is an exception to the general rule that courts will not enforce contracts that grow immediately out of and are connected with an illegal act. Specifically, agreements that are subsequent to an illegal contract but that are independent of it are enforceable. *Brougham v. Swarva*, 34 Wn. App. 68, 80, 661 P.2d 138 (1983), explains:

> [I]f the promise sued upon is related to an illegal transaction, but is not illegal in and of itself, recovery should not be denied, notwithstanding the related illegal transaction, if the aid of the illegal transaction is not relied upon or required, or if the promise sued upon is remote from or collateral to the illegal transaction, or is supported by independent consideration.

To be independent of the illegal contract, and therefore enforceable, a party must show "a right of recovery without relying on the illegal contract and without having the court sanction the same he may recover in any appropriate action." *Id*.; *see also Bena v. Schleicher*, No. 47576-6-II, 198 Wn. App. 1070 (2017) (unreported) (same).

The Newcomer Apex TIC LLC Agreement and the Apex Penthouse Condos LLC Agreement are independent from the Apex Apartments LLC Agreement that the Decision and Order deems void. Newcomer presented no evidence to the Superior Court, and there was no finding that any of the subsequent LLC agreements or the property

transfers and divisions resulting from the multiple ownership restructurings were affected by Mr. Cohen's supposed misrepresentations. Without any evidence and without a finding that the misrepresentations affected these subsequent agreements and property transfers, it was error for the Superior Court to void the Newcomer Apex TIC LLC Agreement and the Apex Penthouse Condos LLC Agreement and potentially void every agreement, transfer, and transaction that was ever entered into in connection with this $26.5 million real estate development.[14]

b. **RCW 21.20.430(5) Does Not Prevent Innocent Parties from Enforcing the Capital-Call Obligations Against Newcomer.**

The Superior Court also erred by voiding the Newcomer Apex TIC LLC Agreement and the Apex Penthouse Condos LLC Agreement because voiding these agreements prevents innocent parties from enforcing them against Newcomer. Before the Superior Court voided these agreements in its Decision and Order, the other investors had the right to enforce Newcomer's commitment to make additional capital contributions for (a) the Phase I partnership via the Newcomer Apex TIC LLC Agreement and (b) the Apex Penthouse Condos LLC. These

[14] Alternatively, if the Superior Court's ruling were correct, and any contracts that grew out of the Apex Apartments LLC Agreement were void, then the Note that Newcomer is attempting to enforce in this lawsuit should also be considered void because the Note grew out of the Apex Apartments LLC Agreement to the same extent, if not more, than the Newcomer Apex TIC LLC and Apex Penthouse Condos LLC Agreements did.

investors are the other defendants and third-party defendants in this lawsuit.

Newcomer never accused any of these investors of committing any securities violations, and the *Newcomer I* court never found that these investors had committed securities violations. Thus, by its plain terms, RCW 21.20.430(5) does not prevent these investors from enforcing Newcomer's capital-call obligations. *See* RCW 21.20.430(5) (applying only to a "person who has made or engaged in the performance of any contract in violation of any provision of this chapter or any rule or order hereunder, or who has acquired any purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation...."). RCW 21.20.430(5) does not support the Superior Court's decision to void the Newcomer Apex TIC LLC Agreement and the Apex Penthouse Condos LLC Agreement, thus preventing the innocent investors from enforcing Newcomer's capital-call obligations. The Decision and Order must therefore be reversed on this additional ground.

VI. CONCLUSION

For all of the foregoing reasons, as well as those set forth in the other appellants' briefs, this Court should reverse the Superior Court's

February 14, 2017 memorandum decision and its accompanying February 24, 2017 order.

Respectfully submitted this 14th day of August, 2017.

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I declare that on August 14, 2017 I caused a true and correct copy of the foregoing to be served on the following in the manner indicated:

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I declare under penalty of perjury under the laws of the state of Washington that the foregoing is true and correct.

Dated this 14th day of August, 2017.

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